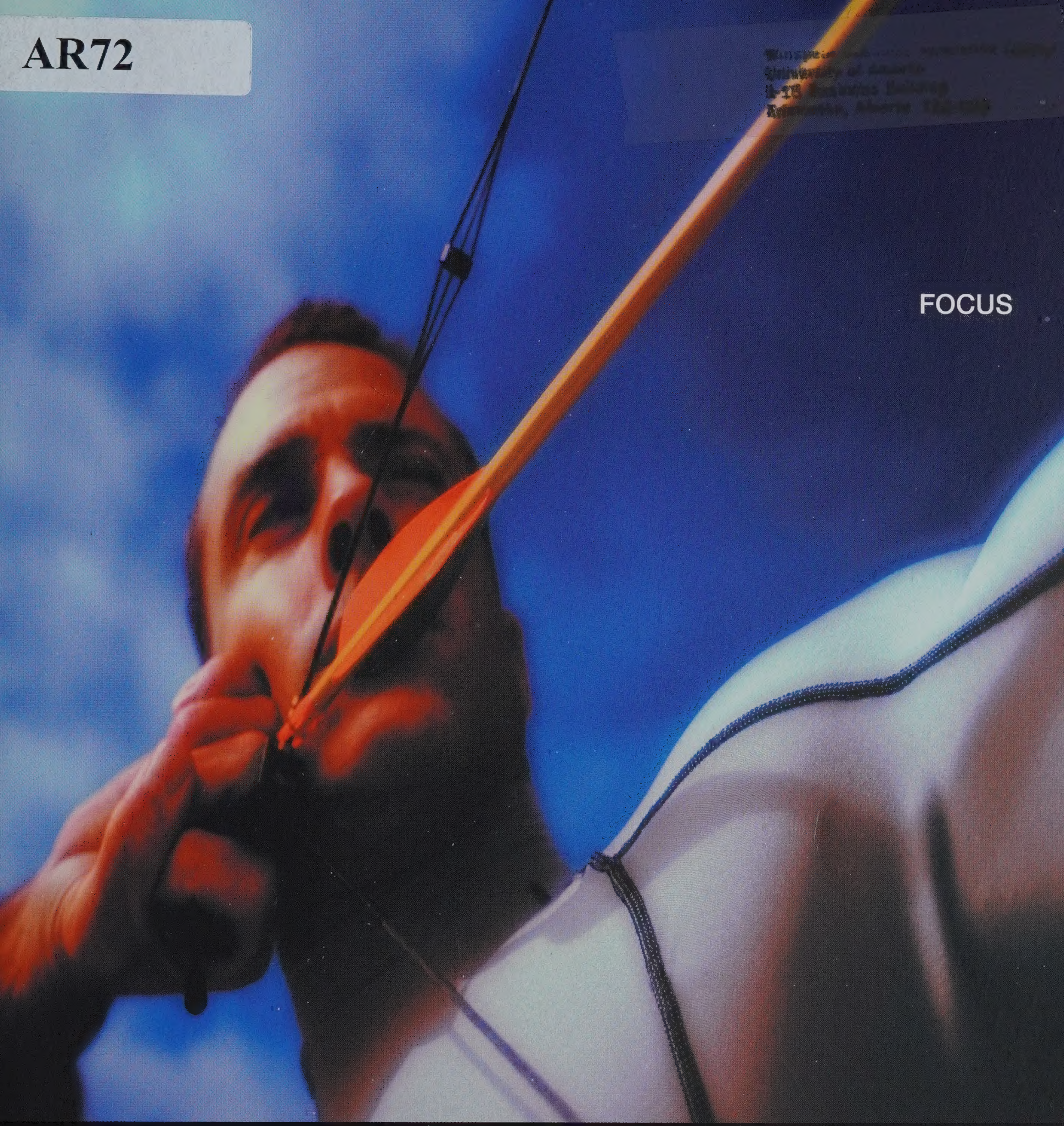


PHOENIX TECHNOLOGY SERVICES INC. Annual Report 2003

PHX

PHOENIX TECHNOLOGY SERVICES INC. provides directional and horizontal drilling technologies and services to the oil and gas industry. Founded in 1985, the Company has emerged as a leading directional drilling contractor in Canada. Headquartered in Calgary, Alberta, Phoenix also operates in the United States through Nevis Energy Services Inc. which is based in Houston, Texas. Research, development and manufacturing operations in Calgary have produced precision measurement technologies that place Phoenix at the forefront of the industry.

The **ANNUAL GENERAL MEETING** of Phoenix Technology Services Inc. will be held on May 10, 2004 from 8:30 to 10:30 a.m. at the Bankers Hall Auditorium, Lower Level, 315–8th Avenue SW, Calgary, Alberta.

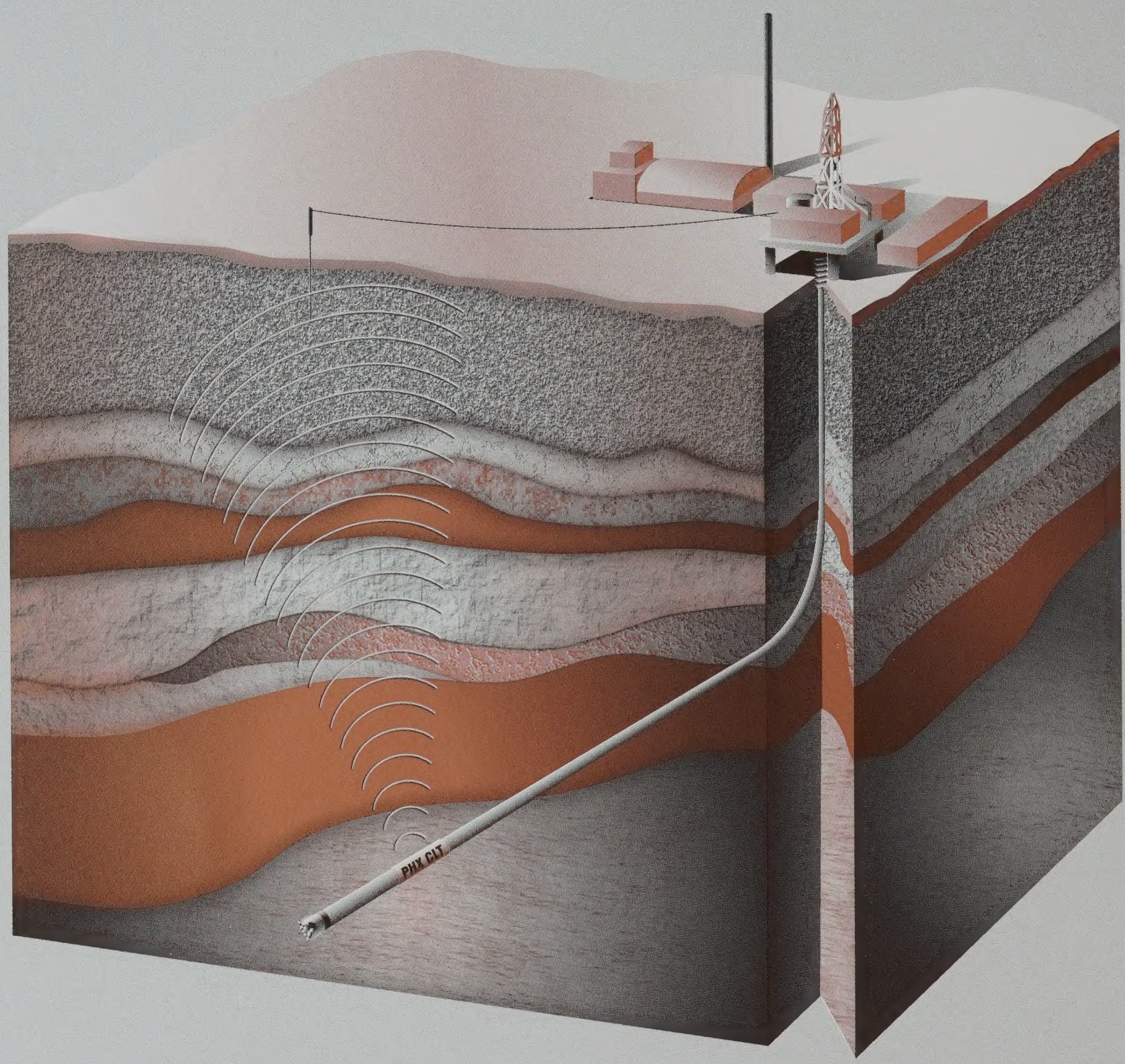
CONTENTS

FOCUS
on shareholder value

2003 SHARE PRICE INCREASE

$0.80	$0.98	$1.08	$1.51	$3.35
Dec 31, 2002	Mar 31, 2003	Jun 30, 2003	Sep 30, 2003	Dec 31, 2003

PHOENIX'S CURRENT LOOP TELEMETRY TECHNOLOGY

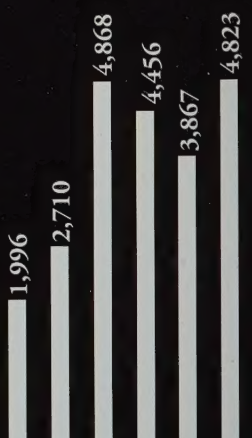


UNDERSTANDING OUR BUSINESS

HORIZONTAL DRILLING:

To achieve increased production rates from certain formations and to maximize reserve drainage, oil and natural gas companies may choose to drill into some formations horizontally. These drilling techniques increase well-bore exposure to the hydrocarbon-bearing rock. Although more expensive than a traditional, vertically drilled well, a horizontal well starts with a vertical shaft, but at a predetermined depth, the bit is "steered" to drill horizontally or parallel to the bedding plane of the formation. As formerly marginal shallow gas and heavy oil prospects become increasingly economic, and as producing basins continue to mature, horizontal drilled wells constitute a large proportion of the total number of wells drilled.

HORIZONTAL AND DIRECTIONAL WELLS DRILLED IN WESTERN CANADA



CREATING SHAREHOLDER VALUE

By Delivering Value to Customers

Phoenix Technology Services Inc. is committed to delivering the greatest possible value in drilling technologies and services to the horizontal and directional drilling industry. The Company's technologies provide the precision that is increasingly required to maximize production from oil and gas properties within mature North American basins.

Through Quality Growth

Investment in research and development, acquisitions, and effective marketing drove consolidated revenue growth of 134 percent in 2003, well above the western Canadian industry growth of 25 percent (industry growth measured by the number of horizontal and directional wells drilled in comparison to 2002). These investments also resulted in a much broader customer base and the identification of substantial, growing, high-value markets for the Company's products and services.

Through Operational Excellence

Phoenix's dedication to high standards of operational efficiency and to disciplined financial management delivered solid shareholder value – $0.25 net earnings per share in 2003.

UNDERSTANDING OUR BUSINESS

MUD PULSE VERSUS PHOENIX'S CURRENT LOOP TELEMETRY OR CLT:
In order for a driller to accurately direct a drill bit, depth, direction and formation measurements must be continuously transmitted to the surface for interpretation. Telemetry systems do this work. Mud pulse telemetry transmits down-hole data to the surface by generating pressure pulses in the drilling mud or fluid; the mud acts as a "telephone line" to surface. Using this analogy, Phoenix's CLT system is wireless. It transmits data to surface through specific electromagnetic frequencies.

DRILLING WITH FLUID AND UNDERBALANCED DRILLING:
Conventional drilling typically uses a specific fluid called drilling mud, pumped to and carried inside the drill string, to control the pressures encountered in deep formations and to supply power and lubrication to the drill bit. Underbalanced drilling is mud-less drilling that employs compressed gas. This process is favoured to reduce formation damage and impair its ability to produce.

PRESIDENT'S MESSAGE


John Hooks
President
and Chief
Executive
Officer

Focus on Performance – Record Results

Phoenix had a record year in 2003. The Company's focus on a few key business areas helped set new highs for total revenue and profitability and established Phoenix as one of the top providers of horizontal and directional drilling services and technology in North America.

In Phoenix's first full calendar year as a public company we set new highs in several key categories. Earnings of $4.3 million, EBITDA of $7.8 million, and cash flow from operations of $8.5 million were the highest in the Company's history. As a percent of revenue, gross profit was 38 percent, up from 35 percent in 2002. Cash flow was over four times that of 2002. The Company also announced its first semi-annual dividend of $0.05 per share and Phoenix's stock price appreciated from $0.80 at the start of the year, to $3.35 per share at the end of 2003. By any financial measure it was an excellent year for Phoenix.

Both the Canadian and United States divisions achieved solid results, and the Company's equipment ran at a utilization rate of 43 percent, approaching the highest rates ever.

While Phoenix benefited from a strong drilling year in North America, the Company grew at rates exceeding industry growth. The growth was a result of our solid marketing efforts and our investment in research and development. The Company is poised, with its strategic acquisitions and the full commercialization of the Current Loop Telemetry (CLT) system, for tremendous growth over the next several years as this technology becomes the drilling method-of-choice for oil and natural gas producers.

Focus on Quality, Accretive Acquisitions

The acquisition of Nevis Energy Services Inc. in late 2002 added a fleet of compatible equipment, an increased quality marketing department and greater revenue to Phoenix.

It also broadened the Company's client base, contributing to an increase in the number of clients, including small and large oil and gas producers. Phoenix now has a significant presence in the United States, headed by an experienced management team, that provides the Company with an important and solid base from which to distribute our new products and services throughout the United States.

In February, 2004, we announced our intent to replicate the Nevis success with the acquisition of Canadian-based Radius Directional Services Inc. Radius possesses excellent characteristics including a solid marketing team and a strong customer base – all traits that bolster Phoenix's strengths. In addition, Radius was operating at a level in excess of its owned equipment capacity, and presently Phoenix is manufacturing new systems to meet this equipment shortage by mid-year. The Company closed its purchase of Radius in March 2004.

Focus on Technology – Current Loop Telemetry System Commercialized

The Company's investment in research and development on the CLT system is yielding Company-transforming results.

The system became fully commercial in 2003, giving Phoenix a technological advantage in a growing new market and again broadening the Company's client base. Phoenix is one of a handful of companies that have successfully commercialized this technology and it opens up major new sources of revenue for the Company.

In underbalanced drilling applications, technologies such as Phoenix's CLT are required. With limited competition in this field, and the increasing demand for underbalanced applications, these telemetry systems will continue to command significantly better margins than conventional mud pulse systems.

With the increasing interest in underbalanced, steam-assisted gravity drainage (SAG-D), heavy oil and coal bed methane in the North American basins, all of which based on the application, require or prefer EM transmitted technology in horizontal and directional drilling, the CLT positions Phoenix at the technical and operational forefront of the industry.

Our Employees – Aiming High

Key to Phoenix's success was the contribution of our employees. The Company's marketing staff consistently provided the highest level of support to our clients. The operations staff provide reliable equipment, resulting in increased levels of utilization in a competitive environment. Our research and development team provided Phoenix with a tremendous springboard for growth; given a clear goal they delivered a robust and quality product, the new CLT system, which will generate much of the Company's future expansion.

I thank the employees for their contribution to Phoenix's outstanding growth in 2003.

Focus on the Future

I am excited about the future of the Company. Our best direction for growth, and for achieving the goals we want to accomplish, has never been more clear.

The purchase of Radius will allow Phoenix to continue expanding its fleet, customer base and revenues.

The Company's research and development team is working on product additions to the CLT system that will provide drillers with even more precise directional control. This product will begin field testing in the first quarter of 2004.

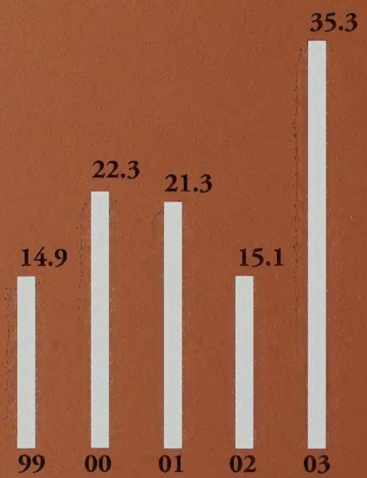
I would like to thank our Board of Directors for their knowledge and guidance. I would also like to thank our shareholders for their continuing support as we enter an exciting phase of our Company's growth.

On behalf of the Board of Directors,

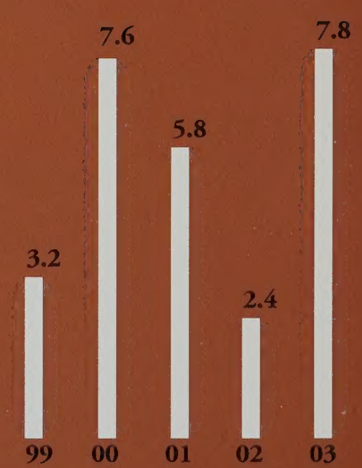
John Hooks
President and Chief Executive Officer
February 25, 2004

$7.8m

FOCUS
on operational excellence
delivered $7.8m of earnings before
income tax, amortization and
depreciation



REVENUE
($ millions)



EBITDA
($ millions)

OPERATIONS REVIEW

Phoenix Services

Phoenix provides drilling technologies and services that allow oil and natural gas producers to accurately drill horizontal and directional wells into hydrocarbon-bearing formations. Clients use Phoenix's technology and services to continuously measure and "steer" the drill bit on a pre-determined trajectory until the target is reached at a precise sub-surface location. As oil and gas companies strive to increase production by pursuing more difficult-to-access resources in mature North American basins, accuracy in placing the well-bore is critical to maximizing recoverable resources.

Phoenix, with its headquarters, operations and technical facilities in Calgary, is active in western Canada and throughout the United States. Our operations in the United States are handled from a regional operations centre in Houston. The Company now has close to 100 employees throughout North America.

Phoenix's clients include many small and mid-size producers, as well as major oil and gas corporations that operate in the energy sector.

Horizontal and Directional Services

Canadian Division

Canadian operations are headquartered in Calgary and employ 76 people, of whom 25 are located at head office, 21 at the operations and technical centre, and 30 in field operations.

Phoenix's Canadian fleet consists of 23 conventional QDT MWD, and Geolink MWD mud pulse telemetry systems. As of December 31, 2003, seven of the Company's new CLT systems were utilized in drilling applications. During 2004, the Company expects to manufacture a minimum of eight additional CLT systems.

The Company's business is heavily influenced by oil and natural gas prices. Strong commodity prices for crude averaging US$31.06 per barrel (WTI) and natural gas averaging US$6.68 per thousand cubic feet (AECO) led producers to invest heavily in drilling programs in 2003, drilling a total of 4,823 horizontal and directional wells in western Canada. By comparison in 2002, the industry drilled 3,867 horizontal and directional wells.

Phoenix's client list expanded to 76 in 2003 from 65 in 2002, the result of concerted marketing efforts and the retention of clients brought to Phoenix in the Nevis acquisition. This reduced the Division's dependency on a select group of major clients and provided the Company with a more stable base for growth.

Competitive price pressure on day rates for the Company's conventional mud pulse units stabilized in 2003 and the Company enjoyed an excellent equipment utilization rate of 43 percent, compared to 2002's rate of 25 percent. The Company considers 67 percent to be the maximum achievable utilization considering the necessary down-time, in-transit between jobs and scheduled maintenance.

Oil and gas companies require Company-developed CLT technology to accurately guide the drill bit during underbalanced drilling operations. Day rates on applications requiring the Company's new

CLT equipment were significantly higher than on conventional mud pulse systems. The CLT system transmits data faster than mud pulse systems, is less expensive to operate because it has no moving parts, and is designed for easy operation. Demand for CLT can be expected to grow as steam assisted gravity drainage (SAG-D) heavy oil, coal bed methane (CBM), and shallow gas production continues to increase.

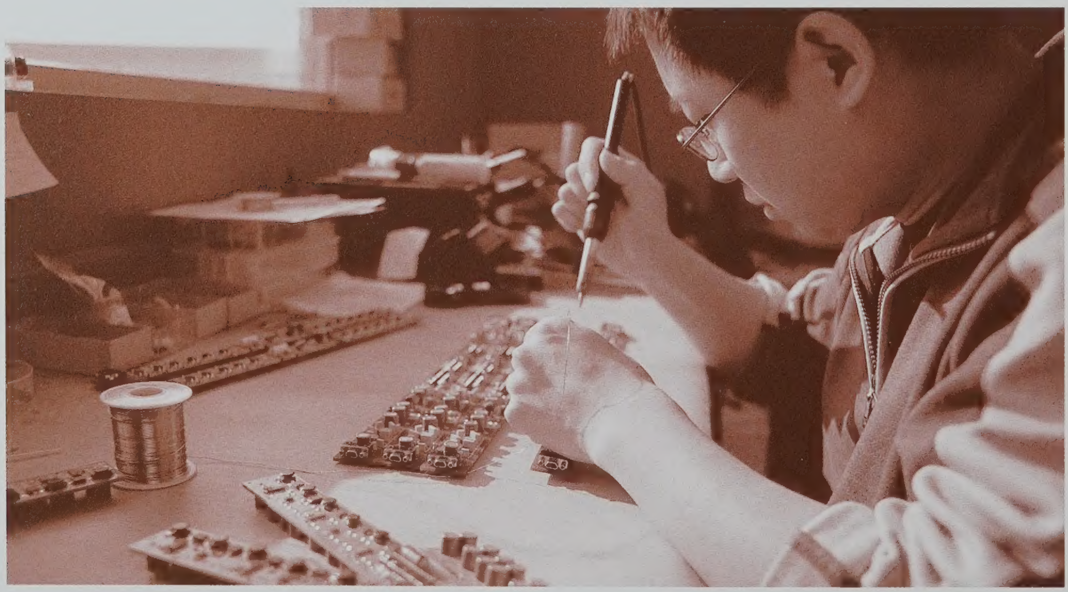
Phoenix is in the advanced planning stages of increasing its Calgary manufacturing capacity for CLT units. The Company plans to manufacture 11 CLT kits for use in its own fleet by the end of 2004. Manufacturing of the Company's own tools will facilitate expansion of its service fleet at very low cost. Additional units will be manufactured and sold to directional and horizontal drilling service providers outside of the Company's core market. Sales of the CLT systems are expected to contribute to the Company's revenue in 2004.

The Division also manufactures high-efficiency lithium batteries, primarily for use in its own tools, at significant cost savings. Approximately 600 batteries that utilize Phoenix's SmartChip energy optimization technology were manufactured at the Company's Calgary technical and operations centre in 2003.

United States Division

Phoenix's division in the United States, Nevis Energy Services Inc., provides fully staffed directional and horizontal drilling services as well as rentals of MWD equipment to the energy sector in Texas, the Rocky Mountain states and offshore Gulf of Mexico and South America. The Division's sales, operations and field staff of 17 relocated to a larger Houston facility in 2003 to accommodate the group's growth.

Equipment rentals constituted approximately 70 percent of the total Division revenue of $8.6 million in 2003, approximately 24 percent of the Company's consolidated revenue.



Strong commodity prices for oil and natural gas drove increased spending on drilling by oil and gas producers in 2003, which in turn improved the Division's revenues.

At year-end 2003, the Division's fleet consisted of 10 conventional positive pulse units. The equipment had a 50 percent utilization rate, versus 22 percent in 2002. The Company expects to deploy CLT kits into the United States market in the first half of 2004. These kits will allow the Division to expand its client base and gain entry into underbalanced and coal bed methane drilling applications.

JAG Rentals

This Division rents down- hole equipment to the oil and gas industry in Canada. Tools such as drilling jars, shock tools, stabilizers and down-hole performance drilling motors are rented on an hourly or daily basis. The Division performed well in 2003, adding approximately 25 jars and 18 down-hole performance motors, as well as increased utilization rates over 2002. JAG operates with seven employees out of a facility in Calgary. The Division contributed $1.1 million to Company revenues in 2003.

Quality and Safety Practices

Quality control continues to be a priority at Phoenix as its tools are critical to the successful completion of client's drilling projects, costs of which may run into millions of dollars. Phoenix's clients demand high levels of service and accordingly the Company's measurement tools and quality control procedures are designed to deliver in-service reliability.

Phoenix had an excellent safety year in 2003. The Company experienced no lost-time accidents at its locations and job sites and continues to emphasize a safe working environment and safe working methods.

Acquisitions

The Company made no substantial corporate acquisitions in 2003. On March 9, 2004, Phoenix closed its acquisition of Radius Directional Services Inc., a Calgary-based directional and horizontal drilling services provider.

The combined entity will realize a number of benefits. Radius has an experienced team of technical marketers and operational personnel, a substantial customer base, and currently rents MWD equipment to meet a substantial portion of its contractual obligations. Phoenix will provide equipment to replace the higher-cost rental equipment that Radius would have required for its contracts.

Phoenix's strategy is to continue pursuing quality acquisitions that will bolster its market presence, add shareholder value, and bring tangible immediate benefits to the Company.

New Product Development

Two years of focus on new product development culminated in 2003 with the commercialization of the Company's CLT measurement tool. With seven units in the field by the end of 2003, this success proved that Phoenix has the capacity to develop and manufacture advanced-technology horizontal and directional drilling tools that are able to compete with multinational competitors.

Development projects are underway on products that enhance the CLT tool, and that give horizontal and directional drillers extremely precise control of drill bit position.

At present, the CLT measurement tool is mounted approximately 30 feet behind the drill bit owing to practical space limitations in the drill string. The operator of the equipment therefore, must correct for small directional errors 30 feet after-the-fact. Sensors placed close to the drill bit will allow real-time correction of drilling direction, further sharpening precision of the drilled hole in applications such as SAG-D where vertical alignment of horizontal wells is critical. Phoenix began downhole testing of Company-developed near-bit sensors for its CLT units during the first quarter of 2004.

The Company is also engaged in improving signal quality of the CLT system and is developing technology that will enable the CLT system to operate and extend the drilling depths and distances that are currently being obtained.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the financial condition and results of operations should be read in conjunction with the consolidated financial statements and accompanying notes contained in this annual report.

Through a strategic acquisition in 2002 and sustained high world oil and natural gas prices in the year, Phoenix achieved record yearly revenue, EBITDA, cash flow and net earnings for the year ended December 31, 2003. The Company achieved a near-record MWD utilization rate of 43 percent in 2003 as compared to 25 percent in the prior year. Exploration and development companies expanded their capital drilling budgets in 2003. This was evident from the 25 percent increase in the number of horizontal and directional wells drilled in western Canada in 2003 to 4,823 wells.

Financial Highlights

Years ended December 31, 2003 and 2002
(Stated in thousands of dollars except per share amounts and shares outstanding)

Operating Results	**2003**	**2002**	**% Chg**
Revenue	**35,343**	15,089	134
Net earnings (loss)	**4,258**	(1,203)	n.m.
Earnings (loss) per share – basic	**0.25**	(0.08)	n.m.
Earnings (loss) per share – diluted	**0.25**	(0.08)	n.m.
EBITDA (1)	**7,780**	2,355	230
EBITDA per share – diluted (1)	**0.45**	0.16	181
Cash Flow			
Cash flow (2)	**8,475**	2,006	322
Capital expenditures	**4,354**	1,249	249
Financial Position			
Working capital	**13,509**	10,409	30
Long-term debt (3)	**3,500**	4,700	(26)
Shareholders' equity	**28,064**	27,494	2
Common shares outstanding, end of year	**16,908,649**	17,303,052	(2)

n.m. – not meaningful

(1) Earnings before interest, income taxes, depreciation and amortization (EBITDA) and EBITDA per share are not recognized measures under Canadian generally accepted accounting principles (GAAP). Management believes that in addition to net earnings, EBITDA and EBITDA per share are useful supplemental financial measures. EBITDA provides an indication of the results generated by the Company's principle business activities prior to consideration of how those activities are financed or how the results are taxed in various jurisdictions. Investors should be cautioned, however, that EBITDA and EBITDA per share should not be construed as alternatives to net income determined in accordance with GAAP as an indicator of Phoenix's performance. Phoenix's method of calculating EBITDA and EBITDA per share may differ from other companies and, accordingly, these financial measures may not be comparable to those used by other companies.

(2) Cash flow is defined as cash provided from operations before changes in non-cash working capital items.

(3) Excludes current portion of long-term debt.

Revenue

In 2003 Phoenix reported record revenue of $35.3 million which was 134 percent higher than revenue of $15.1 million for the prior year. Revenue generated in western Canada in the 2003 year was 98 percent higher at $26.7 million compared to $13.5 million in 2002. Revenue generated out of the United States ("US") geographical region increased over five-fold to $8.6 million for the year ended December 31, 2003, from $1.6 million for 2002. A significant operational presence in the U.S. was created and realized by Phoenix through the Nevis acquisition that occurred in late 2002.

JAG Rentals, which enjoyed its first full year of operations, reported revenue of $1.1 million for the year ended December 31, 2003 as compared to $0.3 million in the 2002 year.

Operating Costs and Expenses

Direct costs relate to Company field and shop operations and include the activities of the Company's research and development centre. Direct costs of $22.0 million represented 62 percent of revenue for 2003, compared to $9.9 million or 65 percent of revenue for 2002. Correspondingly, gross profit as a percentage of revenue, increased from 35 percent in 2002 to 38 percent in 2003. Research and development expenses included in direct costs for 2003 were approximately $0.5 million versus $0.3 million in 2002. This increase in gross profit, as a percentage of revenue, is attributable generally to higher Company activity levels and lower third-party equipment rentals and repairs on down-hole mud motors. The Company is pleased with its gross profit result in 2003 despite having incurred approximately $1.1 million in third-party EM equipment rental costs in the first quarter of 2003. Phoenix's future utilization of its CLT technology is expected to reduce the Company's requirements to incur significant third-party EM system rental costs in 2004.

Selling, general and administration (SG&A) costs for 2003 of $5.6 million increased by 75 percent, compared to $3.2 million for the prior year. As a percentage of revenue, SG&A costs were 16 percent in 2003 compared to 21 percent in 2002. The increase in SG&A in dollar terms is mainly attributable to the increase in activity in the year and the Nevis acquisition. The Company would normally expect that with its current cost structure and its expectation of increases in activity, SG&A costs are anticipated to be less than 14 percent of revenue in 2004.

GROSS PROFIT
(% of Revenue)

Depreciation and amortization expenses increased 59 percent in 2003 to $2.7 million from $1.7 million in 2002. This increase is the result of the addition of $8.6 million in capital assets from the Nevis acquisition and from $4.4 million in capital additions in the current year.

The Company reported a foreign exchange loss of approximately $0.7 million for 2003 compared to a foreign exchange gain of $0.3 million for 2002. The majority of the loss in 2003 and the gain in 2002 relate to the foreign currency translation of notes receivable of US$2.5 million which originated from the Well Director® asset sale in May 2002.

Interest on long-term debt increased 44 percent to $0.23 million in 2003 compared to $0.16 million for the prior year. This increase was again largely the result of the Nevis acquisition which added $3.5 million in long-term debt.

Interest income increased by 16 percent to approximately $0.22 million for 2003 compared to approximately $0.19 million for 2002. The increase in interest revenue is a result of higher cash balances carried throughout 2003. It is expected that interest income earned on excess cash balances in 2004 will decline due to the cash that was utilized to close the Radius acquisition in March 2004.

The Company realized a net gain on the disposition of drilling equipment in 2003 of $0.7 million compared to $0.1 million for the prior year. These gains are the result of down-hole equipment losses that occur.

During the year, Phoenix recognized a $759,000 income benefit associated with future investment tax credits. These tax credits relate to past years' scientific research expenditures made by the Company, and were assessed by Canada Customs and Revenue Agency during 2003. The portion of the investment tax credit associated with Well Director® expenditures was $702,000, and this amount has been disclosed under the classification of investment tax credit on the earning statement.

Income Taxes

Income tax expense totaled approximately $1.6 million for 2003 compared to an income tax recovery of $0.5 million. The Company's effective income tax rate of 27 percent for 2003 was lower than the expected statutory rate of 37 percent due to non-taxable portions of gains on disposition of drilling equipment and recognition in 2003 of previous years' US tax loss carry-forward amounts.

EBITDA for 2003 was $7.8 million or $0.45 per share on a diluted basis. This was 230 percent higher than $2.4 million or $0.16 per share on a diluted basis for 2002.

Net earnings for 2003 were $4.3 million or $0.25 per share on a diluted basis compared to a net loss of $1.2 million or $0.08 per share loss on a diluted basis in 2002. In May 2002, the Company sold its Well Director® assets resulting in a pre-tax loss on disposition of $2.4 million and a diluted loss per share of $0.11.

Liquidity

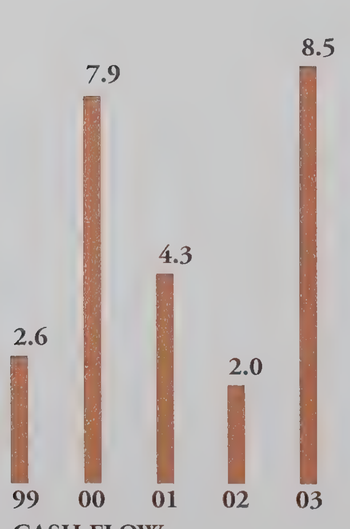
Cash flow generated from operations for 2003 amounted to $8.5 million, an increase of 325 percent from $2.0 million that was generated in 2002. On December 31, 2003, Phoenix held $7.5 million in cash and cash equivalents, and maintained a working capital position of $13.5 million. This compares to cash and cash equivalents of $7.9 million and working capital of $10.4 million on December 31, 2002. The Company has access to a demand operating loan facility of $3,500,000 that bears interest at the bank prime rate plus 0.375 percent. No amounts were drawn on this facility at the end of 2003.

On December 31, 2003 Phoenix paid out dividends to its common shareholders on record on December 17, 2003 the aggregate amount of $845,434 or $0.05 per common share outstanding. There were no dividends paid in 2002.

Capital Resources

Phoenix had long-term debt, excluding current portion, of $3.5 million at year-end 2003, compared to $4.7 million at year-end 2002. The Company's term facility, in the original amount of $6.0 million, resulted from the 2002 consolidation of Phoenix's former term facility with the acquired debt of Nevis. The facility requires monthly principal repayments of $100,000 plus interest. Interest is payable at the Company's option at either the bank prime rate plus 0.50 percent or, at the banks' bankers' acceptance (BA) rate plus a stamp fee of 1.25 percent. On December 31, 2003 a balance of $4.6 million was outstanding under a BA facility, with a fixed interest rate of four percent and a maturity date of January 12, 2004.

The Company has access to a revolving 60-month term facility of up to $1,000,000 for the purpose of financing future equipment acquisitions. The facility had not been drawn as at December 31, 2003. The facility also allows the Company to fix interest rates through BAs.



CASH FLOW
($ millions)

Investing Activities

Due to the increase in activity in 2003 Phoenix incurred significantly more in capital expenditures in the year in comparison to 2002. The Company made capital expenditures of $4.4 million in 2003 compared to $1.2 million for the prior year. The 2003 expenditures, which were financed out of the Company's cash flow, included; $1.3 million in Jag rental equipment additions comprised mainly of down-hole drilling jars and high performance mud motors; $0.8 million in CLT equipment additions; and $2.3 million in various horizontal and directional drilling equipment.

Cash Requirements

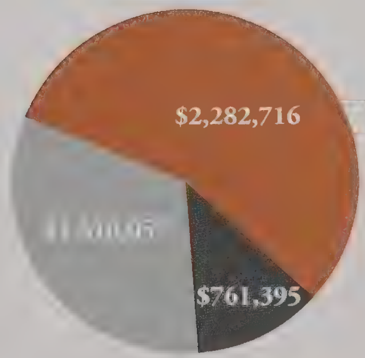
The Company believes that its strong balance sheet and unutilized borrowing capacity, combined with its estimated 2004 cash flow from operations, will provide sufficient capital resources to fund its 2004 capital expenditure program of approximately $2.8 million.

Business Risks and Outlook

Phoenix is highly reliant on the level of capital expenditures made by oil and natural gas exploration and development companies. In turn, this capital spending is based on, but not limited to, oil and natural gas commodity prices, resulting cash flows and access to capital. Current industry forecasts are predicting slight decreases in industry drilling activity and capital spending in 2004.

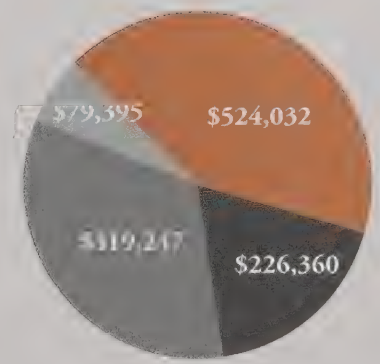
Although Phoenix believes that it is difficult to predict with any degree of certainty future activity levels, the Company is budgeting for increased revenue in 2004 due in part to the equipment capacity and new customer base that were obtained from the closing of the Radius acquisition in early 2004. The Company expects competition within the horizontal and directional industry in North America to remain strong throughout the year and pricing to remain very competitive.

In 2004, Phoenix plans to implement a fairly significant capital expenditure program and pursue further business combinations such as the Radius acquisition. The Company is prepared to respond to abrupt changes in the marketplace and to reduce its capital expenditures quickly if required. Financial and liquidity risks will be minimal as Phoenix maintains a strong balance sheet, with a debt-to-equity ratio that is below industry levels.



2003 NET CAPITAL EXPENDITURES

MWD	53%
CLT	17%
JAG Rentals	30%



2002 NET CAPITAL EXPENDITURES

MWD	42%
CLT	18%
JAG Rentals	34%
WD	6%

The Company is subject to foreign exchange currency fluctuations in relation to its US-denominated notes receivable amounts. The Company's earnings may be subject to large foreign exchange gains or losses from foreign currency movements until the notes are settled. Management believes that this exposure is not material to its overall operations.

The collection of the long-term note receivable amount of US$1.0 million is subject to the future performance of Well Director® runs conducted by the purchaser of these assets during a defined period. Although it is anticipated that the performance level tied to this note will occur before the expiration date and the amount will be collected, there still is a risk that the performance criteria will not be met.

With further internal growth expected from expansion of JAG Rentals and CLT technology, coupled with the anticipated closing of the Radius acquisition, the Company has positioned itself favourably and looks forward to achieving strong financial results during 2004.

Forward-looking Statements.

Except for historical financial information contained herein, the matters discussed in this report may be considered forward-looking statements. Such statements include declarations regarding management's intent, belief or current expectations. Prospective investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve a number of risks and uncertainties. Actual results could differ materially from those indicated by such forward-looking statements. Among the important factors that could cause actual results to differ materially from those indicated by such forward-looking statements are: (i) that the information is of a preliminary nature and may be subject to further adjustment; (ii) the possible unavailability of financing; (iii) risks related to the uncertainty inherent in the oil and gas horizontal and directional services industry; (iv) the impact of energy price fluctuations; (v) the seasonal nature of our business, (vi) start-up risks; (vii) general operating risks; (viii) the dependence on third parties; (ix) changes in government regulation; (x) the effects of competition; (xi) the dependence on senior management, and (xii) fluctuations in currency exchange rates and interest rates.

MANAGEMENT'S REPORT TO THE SHAREHOLDERS

The accompanying consolidated financial statements and all information in the Annual Report are the responsibility of management. The consolidated financial statements have been prepared by management in accordance with the accounting policies in the notes to financial statements. When necessary, management has made informed judgments and estimates in accounting for transactions which were not complete at the balance sheet date. In the opinion of management, the financial statements have been prepared within acceptable limits of materiality, and are in accordance with Canadian generally accepted accounting principles (GAAP) appropriate in the circumstances. The financial information elsewhere in the Annual Report has been reviewed to ensure consistency with that in the consolidated financial statements.

Management has prepared Management's Discussion and Analysis (MD&A). The MD&A is based upon the Company's financial results prepared in accordance with Canadian GAAP. The MD&A compares the audited financial results for the twelve months ended December 31, 2003 to December 31, 2002.

Management maintains appropriate systems of internal control. Policies and procedures are designed to give reasonable assurance that transactions are properly authorized, assets are safeguarded and financial records properly maintained to provide reliable information for the preparation of financial statements.

KPMG LLP, an independent firm of Chartered Accountants, was engaged, as approved by a vote of shareholders at the Corporation's most recent annual general and special meeting, to audit the consolidated financial statements in accordance with generally accepted auditing standards in Canada and provide an independent professional opinion.

The Audit Committee of the Board of Directors, which is comprised of three directors who are not employees of the Corporation, has discussed the consolidated financial statements, including the notes thereto, with management and external auditors. The consolidated financial statements have been approved by the Board of Directors on the recommendations of the Audit Committee.

John Hooks
Chairman of the Board, President
and Chief Executive Officer

Cameron Ritchie, CA
Senior Vice-President Finance
and Chief Financial Officer

AUDITOR'S REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Phoenix Technology Services Inc. as at December 31, 2003 and 2002 and the consolidated statements of earnings, retained earnings and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

KPMG LLP

Calgary, Canada
February 25, 2004

CONSOLIDATED FINANCIAL STATEMENTS AND NOTES

Years ended December 31, 2003 and 2002

CONSOLIDATED BALANCE SHEETS

December 31, 2003 and 2002	Notes	2003	2002
ASSETS			
Current assets			
Cash and cash equivalents		**$ 7,547,533**	$ 7,855,624
Accounts receivable		**9,406,962**	8,261,384
Inventory	4	**614,938**	585,090
Prepaid expenses		**278,892**	323,077
Income tax recoverable		**1,275**	–
Note receivable	5	**1,944,750**	788,800
Investment tax credit receivable		**759,000**	–
		20,553,350	17,813,975
Note receivable	5	**1,296,500**	3,944,000
Drilling and other equipment	6	**16,894,690**	16,600,297
Goodwill		**3,744,731**	3,744,731
		$ 42,489,271	$ 42,103,003
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		**$ 5,844,371**	$ 6,102,852
Current portion of long-term debt	9	**1,200,000**	1,200,000
Income taxes payable		**–**	102,346
		7,044,371	7,405,198
Long-term debt	9	**3,500,000**	4,700,000
Future income taxes	10	**3,881,000**	2,504,000
		14,425,371	14,609,198
Shareholders' equity			
Share capital	11	**20,624,493**	22,542,206
Contributed surplus	12	**519,416**	340,268
Foreign currency adjustment		**(1,104,302)**	–
Retained earnings		**8,024,293**	4,611,331
		28,063,900	27,493,805
Commitments	15		
Subsequent events	5,18		
		$ 42,489,271	$ 42,103,003

See accompanying notes to the consolidated financial statements.

On behalf of the Board:

Chairman of the Board

Director

CONSOLIDATED STATEMENTS OF EARNINGS

Years ended December 31, 2003 and 2002	Notes	2003	2002
Revenue		**$ 35,342,521**	$ 15,088,963
Direct costs		**21,989,102**	9,852,405
Gross profit		**13,353,419**	5,236,558
Expenses			
Selling, general and administrative		**5,625,091**	3,219,967
Depreciation and amortization		**2,666,595**	1,727,140
Foreign exchange loss (gain)		**660,703**	(255,983)
Interest on long-term debt		**228,827**	160,419
Interest income		**(224,517)**	(185,400)
Gain on disposition of drilling equipment		**(712,176)**	(82,925)
		8,244,523	4,583,218
Operating income		**5,108,896**	653,340
Investment tax credit		**(702,000)**	–
Loss on disposition of Well Director® assets	5	**–**	2,404,202
Earnings (loss) before income taxes		**5,810,896**	(1,750,862)
Provision for (recovery of) income taxes	10		
Current		**113,500**	70,000
Future		**1,439,000**	(618,000)
		1,552,500	(548,000)
Net earnings (loss)		**$ 4,258,396**	$ (1,202,862)
Earnings (loss) per share – basic	11b	**$ 0.25**	$ (0.08)
Earnings (loss) per share – diluted	11b	**$ 0.25**	$ (0.08)

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

Years ended December 31, 2003 and 2002	2003	2002
Retained earnings, beginning of year	**4,611,331**	5,814,193
Net earnings (loss)	**4,258,396**	(1,202,862)
Dividends paid	**(845,434)**	–
Retained earnings, end of year	**$ 8,024,293**	$ 4,611,331

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2003 and 2002	Notes	2003	2002
Cash flows from operating activities			
Net earnings (loss)		**$ 4,258,396**	$ (1,202,862)
Add (deduct) items not affecting cash			
Depreciation and amortization		**2,666,595**	1,727,140
Future income taxes		**1,439,000**	(618,000)
Foreign exchange loss (gain)		**660,703**	(255,983)
Loss on note receivable		**78,975**	–
Gain on disposition of drilling equipment		**(712,176)**	(82,925)
Stock-based compensation		**83,614**	34,666
Loss on disposition of Well Director® assets		–	2,404,202
		8,475,107	2,006,238
Change in non-cash working capital	13	**(3,376,600)**	(642,980)
		5,098,507	1,363,258
Cash flows from investing activities			
Proceeds on disposition of drilling equipment		**2,105,356**	326,231
Acquisition of drilling and other equipment		**(4,354,168)**	(1,249,034)
Notes receivable		**709,825**	(4,732,800)
Proceeds on disposition of Well Director® assets		–	13,761,191
Cash acquired on acquisition		–	(982,560)
Acquisition costs		–	(383,001)
		(1,538,987)	6,740,027
Cash flows from financing activities			
Repayment of long-term debt		**(1,200,000)**	(1,438,681)
Dissenting shareholder disbursements	11d	**(1,383,651)**	–
Repurchase of common shares		**(474,524)**	–
Issuance of common shares		**35,998**	–
Dividends paid		**(845,434)**	–
Proceeds on long-term debt		–	135,653
		(3,867,611)	(1,303,028)
Increase (decrease) in cash and cash equivalents		**(308,091)**	6,800,257
Cash and cash equivalents, beginning of year		**7,855,624**	1,055,367
Cash and cash equivalents, end of year		**$ 7,547,533**	$ 7,855,624
Supplemental information			
Income taxes paid		**$ 186,695**	$ 561,500
Interest paid		**$ 226,386**	$ 158,083

See accompanying notes to the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2003 and 2002

Phoenix Technology Services Inc. (the "Company") provides horizontal and directional drilling services to the oil and natural gas industry in western Canada and the United States. The Company also rents various drilling equipment to oil and natural gas companies in western Canada. The Company's head office is in Calgary, Canada and it has an additional sales and service office in Houston, Texas.

1. Significant accounting policies:

(a) **Basis of presentation**

The consolidated financial statements include the accounts of Phoenix Technology Services Inc. ("the Company") and its subsidiaries and partnership, all of which are wholly owned.

(b) **Revenue recognition**

The Company recognizes revenue as services are provided. The Company's services are sold based upon bid acceptances or contracts with customers that include fixed or determinable prices based upon daily, hourly or job rates. Revenue is recognized when services or equipment rentals are provided and when collectibility is assured.

(c) **Cash and cash equivalents**

Cash and cash equivalents consist of cash on hand with commercial banks and investments in bankers acceptances issued by commercial banks and large corporations.

(d) **Inventory**

Inventory is stated at the lower of cost and net realizable value, cost being determined on a specifically identified basis.

(e) **Drilling, other equipment and depreciation**

Drilling and other equipment are recorded at cost. Depreciation is provided over the estimated useful lives of the assets as follows:

Directional drilling equipment	5 to 8 years straight line, 0 to 20% residual value
Rental equipment	5 to 8 years straight line, 0 to 20% residual value
Office and computer equipment	3 to 5 years straight line
Machinery and equipment	5 years straight line
Vehicles	5 years straight line

(f) **Research and development costs**

Research costs are expensed as incurred. Certain product development costs are capitalized once market and technical feasibility has been established. Development costs capitalized are amortized on a straight-line basis over two years once commercial production or use of the product occurs. The Company reviews the recoverability of capitalized development costs on an annual basis to determine if there has been a permanent impairment. The un-amortized portions of these costs are written off in the year where there has been an impairment in value. Equipment acquired to conduct research and development activities are capitalized and amortized over their estimated useful lives.

(g) **Goodwill**

Goodwill is the residual amount that results when the purchase price of a acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed, based on the fair values.

Goodwill is not amortized and is tested for impairment annually in the fourth quarter, or more frequently if events or changes in circumstances indicated that the asset might be impaired. The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting segment is compared to its fair value. When the fair value of the reporting segment exceeds its carrying amount, goodwill of the reporting segment is considered not to be impaired and the second step of the impairment test is unnecessary. The second step is carried out when the carrying amount of the reporting segment's goodwill exceeds its fair value, in which case the implied fair value of the reporting segment's goodwill is compared with its carrying amount to measure the amount of the impairment loss, if any. The implied fair value of goodwill is determined in the same manner as the value of the goodwill in a business combination described in the previous paragraph, using the fair value of the goodwill, an impairment loss is recognized in an amount equal to the excess.

(h) **Foreign currency translation**

The Company's United States ("US") subsidiary is accounted for as a self-sustaining operation. Accordingly, the subsidiary's accounts in foreign currencies and operations have been translated into Canadian dollars using the current rate method. Monetary and non-monetary items denominated in US dollars are translated to Canadian dollars at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at the average exchange rate for the month the transaction occurred. Gains or losses arising on translation are deferred and reported as a foreign currency adjustment as a separate component of shareholders' equity

Transactions denominated in a currency other than Canadian dollars are translated by applying exchange rates in effect at the transaction date. At the end of the year, monetary assets and liabilities denominated in a foreign currency are translated using the exchange rate as at that date. Any resulting foreign exchange translation gains and losses are charged to earnings for the year.

(i) **Per share amounts**

Basic per share amounts are calculated using the weighted average number of common shares outstanding during the period. Diluted per share amounts are calculated using the treasury stock method where deemed proceeds of the exercise of options are considered to be used to re-acquire common shares at an average share price. The weighted average number of shares outstanding is then adjusted by the net change.

(j) **Income taxes**

The Company follows the liability method of accounting for income taxes. Under the liability method, future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment.

(k) **Stock-based compensation plans**

The Company has a stock option plan which is described in note 11(c). Commencing in 2003, the fair value of stock options are expensed over the vesting period. For stock options issued prior to 2003, pro forma disclosure of the effect on net earnings and earnings per share had the fair value been expensed is provided. The fair value of stock options that have been expensed is credited to contributed surplus.

(l) **Use of estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for the year. Actual results could differ from such estimates by a material amount.

(m) **Comparative figures**

Certain comparative figures have been reclassified to conform to current year's financial statement presentation.

2. Change in accounting policies:

(a) **Stock-based compensation**

Effective January 1, 2003 the Company expensed stock options on a prospective basis. Prospective adoption requires that the fair value of compensation costs related to stock options granted in 2003 be expensed in the financial statements over the vesting period. For stock options granted prior to 2003, the Company will continue to provide pro forma disclosure of the effect on net earnings and earnings per share had the fair value been expensed.

(b) **Foreign currency translation**

Effective January 1, 2003, the designation of the Company's foreign subsidiaries was changed from fully integrated to self-sustaining. Accordingly, the subsidiaries accounts in foreign currencies and operations have been translated into Canadian dollars using the current rate method. As the change in classification is due to the 2002 reorganization of the U.S. subsidiaries acquired in November 2002 it has been accounted for prospectively.

(c) **Accounting for business combinations, goodwill and other tangible assets**

Effective January 1, 2002, the Company adopted new accounting standards for business combinations, goodwill and other intangible assets. The Company determined as of the date of adoption that it had one reporting unit. The Company allocated all assets, including goodwill, and liabilities to the reporting unit and conducted the first step of the transitional goodwill impairment test as of the date of adoption. Based on this test, the Company determined that the goodwill recorded was not impaired as at the date of adoption; accordingly no transitional goodwill impairment loss was recognized pursuant to the transitional provisions of the new goodwill accounting standard.

3. Acquisition:

On November 1, 2002, Phoenix Technology Services Ltd. ("Phoenix") completed a plan of arrangement with Nevis Energy Services Ltd. ("Nevis"), a horizontal and directional services company. As a result of this transaction, former shareholders of Phoenix who approved the plan of arrangement received one common share of the Company for each share of Phoenix and former shareholders of Nevis received 0.5 of a common share of the Company for each common share of Nevis. Upon completion of the transaction, the Company had 17,303,052 million shares outstanding.

As a result of the above transactions, the shareholders of Phoenix became the owners of approximately 76% of the issued and outstanding shares of the combined entity. The acquisition has been accounted for as a reverse takeover of Nevis by Phoenix, using the purchase method. The results of operations of Nevis have been included in the consolidated financial statements from November 1, 2002. The fair value of the net assets acquired from Nevis were:

Current assets	$ 3,790,386
Drilling and other equipment	8,575,000
Other assets	18,800
Future income tax assets	443,308
Current liabilities	(3,642,184)
Long-term debt	(3,540,250)
Total consideration of 4,152,467 common shares	$ 5,645,060

A group of shareholders, holding in aggregate, 994,375 Common Shares of Phoenix, exercised their right to dissent under the plan of arrangement and consequently these shares were cancelled. These former shareholders of Phoenix are entitled to be paid fair value for their shares as agreed between the Company and the former shareholders or in an amount established by the Court as per note 11(d).

4. Inventory:

	2003	2002
Parts	$ 230,571	$ 585,090
Work in process and finished goods for re-sale	384,367	–
	$ 614,938	$ 585,090

5. Sale of Well Director® assets and notes receivable:

On May 3, 2002, the Company entered into an agreement to sell its Well Director® assets for cash and notes receivable of US$9 million. Notes receivable of US$2.5 million are to be paid upon the purchaser achieving certain operating targets with the Well Director® tools up to May 1, 2005. As a result of this transaction, the Company realized a loss on disposition of $2,404,202.

The Company's notes receivable are denominated in US Dollars and have been classified in their current and long-term portions based on the terms of the sale agreement. As at December 31, 2003, the Company revalued the notes based on current exchange rates and recorded an exchange loss of $821,050 for the year ended, which was charged to earnings.

Subsequent to the balance sheet date the Company was advised by the purchaser that it had achieved the first of two operational targets from the deployment of the Well Director®, as defined in the May 1, 2002 sale agreement, and the Company received US$1.5 million from the purchaser in February 2004.

6. Drilling and other equipment:

2003	Cost	Accumulated depreciation	Net book value
Directional drilling equipment	$ 22,280,382	$ 7,573,873	$ 14,706,509
Rental equipment	1,685,311	182,957	1,502,354
Office and computer equipment	752,900	535,277	217,623
Machinery and equipment	498,325	294,084	204,241
Vehicles	123,616	31,214	92,402
Deferred costs	294,111	122,550	171,561
	$ 25,634,645	$ 8,739,955	$ 16,894,690

2002	Cost	Accumulated depreciation	Net book value
Directional drilling equipment	$ 21,773,840	$ 6,339,725	$ 15,434,115
Rental equipment	419,248	13,578	405,670
Office and computer equipment	656,328	441,085	215,243
Machinery and equipment	474,537	239,949	234,588
Vehicles	113,838	29,517	84,321
Deferred costs	226,360	–	226,360
	$ 23,664,151	$ 7,063,854	$ 16,600,297

7. Research and development costs:

Development costs capitalized during the year were $67,951 (2002 – $226,360). Research and development costs charged to earnings during the year were $637,436 (2002 – $300,646) that included $122,500 (2002 – $ nil) in amortization of deferred development costs and were net of $57,000 (2002 – $ nil) in investment tax credits received.

8. Bank indebtedness:

The Company has access to a demand revolving loan facility of up to $3.5 million. The demand loan would bear interest at the bank prime rate plus .375% and is secured by security discussed in Note 9.

9. Long-term debt:

	2003	2002
Non-revolving bank loans, with monthly repayments of $100,000 plus interest. Interest, at the Company's option is at bank prime rate plus .50% or at the bank's bankers acceptance rate plus a stamping fee of 1.25%, and will be repaid over a sixty month period. The loans are secured by the security below.	**$ 4,700,000**	$ 5,900,000
Less current portion	**1,200,000**	1,200,000
	$ 3,500,000	$ 4,700,000

Principal payments due are as follows:

2004	$ 1,200,000
2005	1,200,000
2006	1,200,000
2007	1,100,000
	$ 4,700,000

The Company has access to a revolving loan facility of up to $1,000,000 to be used to assist in the acquisition of capital assets. The loan would bear interest at the Company's option at the bank prime rate plus .50% or at the bank's bankers acceptance rate plus a stamping fee of 1.25%. The demand facility, the non-revolving loan, and this revolving loan facility is secured by a general security over all the assets of the Company and hereafter acquired by the Company, assignment of related insurance coverage, and a fixed charge over each asset acquired by the Company under the revolving loan facility.

10. Income taxes:

(a) The provision for income taxes differs from the amounts that would be obtained by applying the expected combined federal and provincial statutory income tax rate of 37% (2002 – 39%) as follows:

	2003	2002
Expected income tax expense (recovery)	$ 2,150,032	$ (687,577)
Add (deduct):		
Non-taxable portion of gains on disposal of drilling equipment	(418,000)	–
Benefit of previously unrecognized tax losses	(182,000)	–
Other	2,468	(65,421)
Lower effective income tax rate on current losses	–	204,998
	$ 1,552,500	$ (548,000)

(b) Future income taxes arise from temporary differences, which are differences between the tax basis of an asset or liability and its carrying amount in the balance sheet. The tax effects of temporary differences that give rise to significant portions of the future tax assets and liabilities at December 31 are presented below:

	2003	2002
Future income tax liabilities:		
Drilling and other equipment	$ 2,068,520	$ 2,256,626
Receivable reserves	1,122,000	1,671,533
Partnership income	1,573,349	1,291,935
	4,763,869	5,220,094
Future income tax assets:		
Unused income tax losses	(707,528)	(2,130,369)
Share issue costs	(170,789)	(196,745)
Other	(4,552)	(388,980)
	(882,869)	(2,716,094)
Net future income tax liability	$ 3,881,000	$ 2,504,000

The Company has available losses of $2,043,697 to reduce future taxable income, of which $1,442,722 will expire in 2008 and $600,975 will expire in 2010.

11. Share capital:

(a) **Authorized and issued shares**

The Company is authorized to issue an unlimited number of common voting shares without nominal or par value. The following is a summary of the Company's issued and outstanding Common Shares:

	2003		2002	
	Number	Amount	Number	Amount
Balance outstanding, beginning of year	17,303,052	$ 22,542,206	14,144,960	$ 17,136,522
Repurchase of common shares	(439,400)	(570,060)	–	–
Issuance of common shares	44,997	35,998	–	–
Dissenting shareholder disbursements	–	(1,383,651)	–	–
Shares issued pursuant to acquisition	–	–	4,152,467	5,645,060
Shares dissented pursuant to acquisition	–	–	(994,375)	–
Acquisition costs, net of income taxes	–	–	–	(239,376)
Balance outstanding, end of year	16,908,649	$ 20,624,493	17,303,052	$ 22,542,206

(b) **Basic and diluted earnings per share**

2003	Income (numerator)	Shares (denominator)	Per share Amount
Basic earnings per share:			
Income available to common shareholders	$ 4,258,396	17,038,077	$ 0.25
Diluted earnings per share:			
Dilutive effect of stock option conversions		180,126	
Income available to common shareholders	$ 4,258,396	17,218,203	$ 0.25

2002	Income (numerator)	Shares (denominator)	Per share Amount
Basic earnings per share:			
Loss available to common shareholders	$ (1,202,862)	14,699,097	$ (0.08)
Diluted earnings per share:			
Dilutive effect of stock option conversions	–		
Loss available to common shareholders	$ (1,202,862)	14,699,097	$ (0.08)

(c) **Stock options**

The Company has a stock option plan for employees, officers, and directors under which stock options are granted under the plan have a five-year term and vest equally over three periods commencing six months after the date of the grant, and the first and second anniversaries thereafter.

During the year, the Company granted 337,500 stock options at average exercise prices between $0.85 to $2.05, with expiration dates between January 10, 2008 to November 24, 2008. As at December 31, 2003, the Company had a total of 1,093,169 options that remain outstanding which expire over a period of four to five years. During the year 44,997 options were exercised at an exercise price of $0.80, and 39,334 options were cancelled.

A summary of the status of the plan as at December 31, 2003, is presented below:

	2003		2002	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding, beginning of year	840,000	$ 0.80	617,500	$ 4.40
Granted	337,500	1.77	840,000	0.80
Exercised	(44,997)	0.80	–	–
Cancelled	(39,334)	0.99	(617,500)	4.40
Outstanding, end of year	1,093,169	$ 1.09	840,000	$ 0.80
Options exercisable, end of year	254,986	$ 0.81	–	$ –

The range of exercise prices for options outstanding at December 31, 2003 are as follows:

	Options Outstanding			Options Exercisable	
Exercise Price	Number	Weighted average remaining contractual life	Weighted average exercise price	Number	Weighted average exercise price
$ 0.80	761,669	4.0 yrs	$ 0.80	231,653	$ 0.80
0.85	50,000	4.0 yrs	0.85	16,666	0.85
0.95	5,000	4.4 yrs	0.95	1,667	0.95
1.00	15,000	4.5 yrs	1.00	5,000	1.00
1.08	10,000	4.6 yrs	1.08	–	–
1.55	5,000	4.7 yrs	1.55	–	–
1.56	2,500	5.0 yrs	1.56	–	–
2.05	244,000	5.0 yrs	2.05	–	–
	1,093,169	4.2 yrs	$ 1.09	254,986	$ 0.81

As disclosed in note 2(a), the Company began prospectively expensing the fair value of stock options granted in 2003 over the vesting period. In accordance with the prospective method of adoption, the Company will continue to record no compensation expense for stock options granted prior to January 1, 2003, and will continue to provide pro forma disclosure of the net effect on net earnings and earnings per share had fair value been expensed.

In accordance with the Company's stock option plan, options have an exercise price equal to the market price at the date of grant.

The weighted average fair value of each option granted by the Company was estimated on the date of grant using the Black-Scholes options pricing model with weighted-average assumptions for grants assuming no dividends are paid on common shares, an average risk-free interest rate range of 4.3%, an average life of 3.0 years, and an expected volatility of 50%. The amounts computed according to the Black-Scholes pricing model may not be indicative of the actual values realized upon the exercise of these options by the holders.

The weighted average fair value price per share of options granted in the years was as follows, 2003- $0.84 (2002- $0.31).

If the fair value method had been used for options issued in 2002, the Company's net earnings and earnings per share would approximate the following pro forma amounts:

	2003	2002
Net earnings:		
As reported	$ 4,258,396	$ (1,202,862)
Pro forma	4,171,396	(1,206,601)
Earnings per share:		
Basic and diluted as reported	$ 0.25	$ (0.08)
Basic and diluted pro forma	0.25	(0.08)

In 2003, the Company recognized a total compensation expense of $28,150 for stock options granted in 2003.

(d) Dissenting shareholders

In 2002, a group of shareholders, holding in aggregate 994,375 Common Shares of the Company, exercised their right to dissent under the plan of arrangement, and consequently these shares were cancelled. These former shareholders of the Company are entitled to be paid fair value for their shares as established by a Court process. During the year, the Company placed an amount of $1,262,857 in trust with the Company's lawyers, which was subsequently paid to the dissenting shareholder's legal counsel. This amount paid will be subject to adjustment once the Court valuation process is complete. Costs associated with the dissent process of $120,794 have been deducted from share capital, net of income taxes of $63,000.

(e) Share escrow

As a result of the acquisition of Nevis Energy Services Ltd. as discussed in note 3 there was 1,571,328 (2002 – 4,812,767) shares held in escrow. Under the terms of the escrow agreement the remaining escrowed shares will be released on May 1, 2004.

12. Contributed Surplus:

	2003	2002
Balance outstanding, beginning of year	$ 340,268	$ 305,602
Gain on repurchase of shares	95,533	–
Stock based compensation expense	83,615	34,666
Balance outstanding, end of year	$ 519,416	$ 340,268

13. Statement of cash flows:

The changes in non-cash operating working capital items is comprised of the following:

	2003	2002
Decrease (increase) in current assets:		
Accounts receivable	$ (1,145,578)	$ (1,797,784)
Inventory	(29,848)	(96,865)
Prepaid expenses	44,185	(4,889)
Investment tax credit	(702,000)	–
Increase (decrease) in current liabilities:		
Accounts payable and accrued liabilities	(258,774)	996,514
Income tax payable	(103,621)	5,143
Foreign currency adjustment	(1,104,302)	–
Foreign exchange	(76,662)	254,901
Change in non-cash working capital	$ (3,376,600)	$ (642,980)

14. Segmented information:

The Company provides directional and horizontal oil and gas well drilling services. The Company's operating segments have been aligned geographically as follows:

2003	Canada	United States	Total
Revenue	26,695,835	8,646,686	35,342,521
Drilling and other equipment	13,296,874	3,597,816	16,894,690
Goodwill	3,744,731	–	3,744,731

2002	Canada	United States	Total
Revenue	13,457,985	1,630,978	15,088,963
Drilling and other equipment	16,151,848	448,449	16,600,297
Goodwill	3,744,731	–	3,744,731

15. Commitments:

The Company is committed to the following minimum payments under operating leases for equipment and premises:

2004	$ 812,000
2005	701,000
2006	233,000
2007	13,000

16. Related party transactions:

During the year the Company paid $209,787 (2002 – $196,757) for the provision of various legal services from a director's firm of which he is a partner.

During the year the Company paid $50,000 (2002 – nil) for the provision of various advisory services to a firm owned by an officer of the Company.

These transactions were completed in the normal course of operations on normal market terms and are measured at the exchange amounts.

17. Financial instruments:

(a) Credit risk

The Company is exposed to normal credit risks of its customers that exist within the oil and gas exploration and development industry.

The collection of the long-term note receivable amount of US$1.0 million is subject to the future performance of Well Director® runs conducted by the purchaser of these assets during a defined period. Although it is anticipated that the performance level tied to this note will occur before the expiration date and the amount will be collected, there still is a risk that the performance criteria will not be met.

(b) Fair values of financial instruments

The carrying values of accounts receivable, accounts payable and accrued liabilities, and income taxes payable approximate their fair value due to the relatively short periods to maturity of the instruments. The fair value of long-term debt included in the consolidated balance sheet approximates fair values as the indebtedness is subject to floating rates of interest.

The fair value of notes receivable is $3,265,471 after discounting the value using the Company's current cost of capital of 3.64% and a foreign exchange rate of 1.3248.

(c) Foreign exchange rate fluctuation

The Company is subject to foreign currency fluctuations in relation to its US denominated notes receivable amounts. The Company's earnings may be subject to large changes from foreign currency movements until the notes are settled. Management believes this exposure is not material to its overall operations.

(d) Interest rate risk

The Company manages its exposure to interest rate risk through floating rate borrowings.

18. Subsequent event:

On February 9, 2004 the Company entered into an agreement, subject to satisfaction of certain conditions, to acquire the assets of a private horizontal and directional services company, Radius Directional Services Ltd., and its wholly owned subsidiary Radius Directional Services Inc. for aggregate consideration of $10.96 million consisting of $5.45 million in cash, the assumption of approximately $1.85 million in debt and the issue of 1.2 million common shares of the Company. The Company and Radius expect the transaction to close during the first week of March 2004, subject to receipt of requisite regulatory and director approval. Completion of the transaction is also subject to completion of final due diligence and the finalization of a definitive agreement.

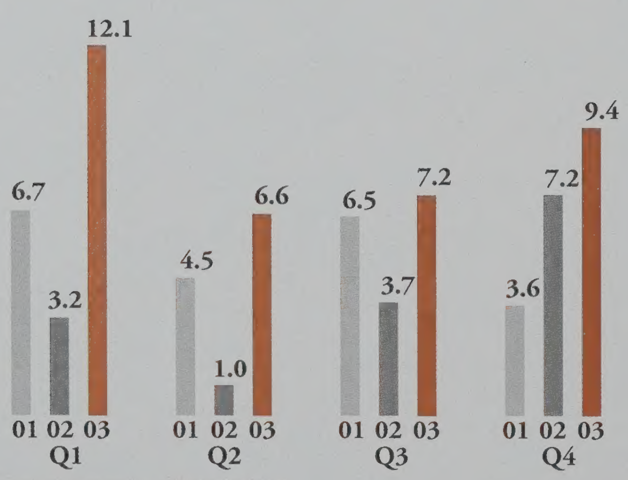
CONSOLIDATED QUARTERLY RESULTS

2003 Results

(Unaudited in $000s except per share amounts)	March	June	September	December	Total
Revenue	**$ 12,077**	**$ 6,625**	**$ 7,207**	**$ 9,434**	**$ 35,343**
Operating income	**1,721**	**822**	**1,373**	**1,193**	**5,109**
Net earnings	**1,413**	**1,161**	**995**	**689**	**4,258**
Earnings per share	**0.08**	**0.07**	**0.06**	**0.04**	**0.25**
EBITDA	**2,337**	**1,495**	**2,045**	**1,903**	**7,780**
EBITDA per share	**0.13**	**0.09**	**0.12**	**0.11**	**0.45**
Cash flow	**2,546**	**1,160**	**1,806**	**2,963**	**8,475**

2002 Results

(Unaudited in $000s except per share amounts)	March	June	September	December	Total
Revenue	$ 3,242	$ 888	$ 3,724	$ 7,235	$ 15,089
Operating income (loss)	458	(974)	455	714	653
Net earnings (loss)	(1,471)	(488)	266	490	(1,203)
Earnings (loss) per share	(0.10)	(0.03)	0.02	0.03	(0.08)
EBITDA	869	(567)	822	1,231	2,355
EBITDA per share	0.06	(0.04)	0.06	0.08	0.16
Cash flow	879	(622)	623	1,126	2,006



QUARTERLY REVENUE (millions $)

CORPORATE INFORMATION

STOCK EXCHANGE LISTING

Common shares of Phoenix Technology Services Inc. are listed on the TSX under the trading symbol "PHX".

CORPORATE INFORMATION

Board of Directors

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Elson J. McDougald

Jeff G. Lawson

James K. Gray, O.C.

Randolf ("Randy") M. Charron

J. Cameron Bailey

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Cameron Ritchie, Sr., Vice President Finance and CFO

Reid Hansen Sr., Vice President

Myron Tétreault, General Counsel and Corporate Secretary

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